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Application of Milwaukee Water Works, Milwaukee County, Wisconsin, for Authority to Increase Water Rates. 3720-WR-107

Q. Please state your name and business address.

A. Carrie Lewis, Milwaukee Water Works, 841 N. Broadway, Milwaukee WI 53202

Q. In what capacity are you appearing as a witness?

A. I am the Superintendent of Milwaukee Water Works.

Q. Why did the Milwaukee Water Works apply for a rate increase?

A. Adequate revenues are required to cover the cost of ongoing operations, maintenance, debt service, and capital reinvestment for our facilities and infrastructure. Rate increases have not generated enough revenue to cover cash outflows in recent years.

Milwaukee Water Works (MWW) has requested three water rate increases since 2002. These were a 3.4 percent simplified rate case effective September 1, 2006, a 6.0 percent increase effective June 1, 2007 through a conventional rate case, and 3.8 percent effective September 1, 2009 through a simplified rate case. The utility made a conscious effort to keep increases low in order to mitigate the impact on customers.

Even with these rate increases, revenues have not covered cash outflows (operating and non-operating expenses, payments in lieu of taxes, debt service payments, and capital improvement projects) for Milwaukee Water Works since 2006. Cash outflows exceeded revenue by \$ 2.6 million, \$ 9.6 million, and \$ 12.3 million in 2007, 2008 and 2009, respectively.

1 The rate of return (ROR) for these three years was 1.97 percent, 0.97 percent, and -0.68
2 percent, respectively. For 2010, a rate of return of -1.01 percent was estimated in the MWW
3 Estimated Operating Income Statement for the requested rate increase test year. This was
4 subsequently amended to -1.14 percent by Public Service Commission of Wisconsin (PSCW)
5 staff. The PSCW benchmark for rate of return for a municipally owned utility was 7.4 percent at
6 the time the application for a rate increase was filed. (The benchmark rate of return was
7 reduced to 6.3 percent in March 2010.) Exhibit 1.1 shows the MWW rate of return in recent
8 years.

9 On the revenue side, metered water sales continue to decline. Even with the addition
10 of four new wholesale customers since 1997, overall metered consumption has declined from
11 41.4 billion gallons in 1997 to 33.3 billion in 2009. And this is down from 58.4 billion in 1976.
12 (See Exhibit 1.2.) The greatest decrease is in the industrial customer class (down 81 percent
13 from 1976 to 2009, with 16.3 billion fewer gallons sold). Metered sales to commercial
14 customers have been relatively stable during this time period. The residential customer class is
15 down 41 percent between 1976 and 2009, representing 8.0 fewer billion gallons sold to this
16 customer class. Since the beginning of the decade, industrial metered sales are down 54
17 percent (4.5 billion gallon reduction) and residential metered sales are down 16 percent (2.2
18 billion gallon reduction). Commercial metered sales have remained relatively constant. Exhibit
19 1.3 depicts the changes in metered sales by customer class from 2000 to 2009.

20 Results for the first quarter of 2010 show a continuing decline in water use, with
21 metered sales down 3.7 percent compared to the same time period in 2009.

22 Meanwhile, significant cost increases have impacted the utility. Examples of cost
23 increases include:

- In 2008, four chemical vendor contracts were renewed with cost increases from 45 percent to 228 percent. Three chemical contracts were renewed in 2009, with increases of 0 percent to 44 percent). (One contract will expire in 2010 and four will expire in 2011; it is unknown how pricing might change in the new contracts.) The overall impact of these price increases is substantial. In 2007, the utility spent about \$ 1.4 million on water treatment chemicals. In 2009, \$ 3.5 million was spent on treatment chemicals. Exhibit 1.3 summarizes price increases in major water treatment chemicals.
- In 2006, Milwaukee Water Works began a cross-connection inspection program for commercial and industrial premises. The program has ramped up over a three year period to a level in which commercial and industrial premises are inspected on a ten-year cycle. Now at a full level of effort, this program adds approximately \$ 1.1 million to the annual operating budget.
- Consolidation of two MWW Distribution field facilities into a single location added about \$ 1.3 million in annual rent and utilities payments to the operating budget. (The utility reaped significant efficiencies from this consolidation; see below.)
- Energy, fuel, and construction supplies (water pipe, clamps and other parts used for repairs) have seen dramatic increases in recent years.
- Expenses for inspection and repair of aging facilities continue to increase. These include Riverside Pumping Station tuck pointing and brick repair (\$ 250,000 expensed in 2008 and \$ 300,000 in 2009), Linnwood Water Treatment Plant roof and chimney repairs (\$ 619,000 expensed in 2007), Linnwood and Howard Avenue Water Treatment Plants intake and crib inspections (\$ 363,000 expensed in 2009).

- The utility's payment in lieu of taxes has increased from \$ 7.8 million in 2007 to \$ 9.4 million in 2009. This is due to a combination of increased asset value and rising tax rates. Beginning in 2010 the utility will pay approximately \$ 1.0 million into the pension fund related to the actuarial valuation of the fund balance in the economic downturn.
- In 2010, the utility will embark on a multi-year program to replace about 156,000 residential and small commercial water meters in the MWW service area.

Milwaukee Water Works strives to continuously improve work processes and methods to operate efficiently and control costs, while providing a high level of service to our customers. Some examples of cost saving measures that have positively impacted our balance sheet include:

- Salary and benefits have been reduced. In 2009, management employees received 0 percent salary increases, started paying a health insurance employee premium, and had increased co-pays on health benefits. All employees were required to take two unpaid furlough days. In 2010 and 2011, all employees (management, union, and non-represented) will be impacted by salary and benefit considerations. There will be no cost of living increases or "step" increases in pay ranges. There will be four unpaid furlough days in 2010, with the expectation that this policy will continue into 2011. Exceptional achievement awards have been discontinued for management. New hires will be required to give a 5.5 percent contribution for pension, up from 1.5 percent for employees hired after 1/1/2000 and 0 percent for employees hired prior to that date.
- Overtime has been reduced by limiting overtime activities to essential (filling absences in 24/7 shift positions) and emergency (such as water main break repairs and flooding)

1 situations. Overtime was down \$ 360,000 when comparing 2007 to 2009 despite base
2 wage increases, and 2010 is on pace for continued decline.

- 3 • The MWW 2009 budget authorizes 348 positions, a 17 percent reduction in full time
4 equivalent positions from 2000 to 2009. This is testimony of the utility's continuous
5 effort to optimizing the organization of work units and increasing productivity. (The
6 2010 budget authorizes 404 positions, reflecting the ramping up of an automatic meter
7 replacement program throughout the retail service area.)
- 8 • The consolidation of two distribution field offices into a single, centralized location has
9 reaped much efficiency. The consolidation allowed for the elimination of duplicated
10 staff, equipment, supplies, materials and recordkeeping. With all personnel at one
11 location, the scheduling of crews for both emergency repairs and maintenance projects
12 provides full utilization of staff and equipment. Most impressive is that the Distribution
13 Section reduced staff from 150 employees to 114 fulltime employees without adversely
14 affecting service levels. Efficiencies are also realized in response to emergencies with all
15 personnel reporting to one location where inventory, repair supplies, tools and vehicles
16 are located. In addition, construction vehicles are parked inside the heated garage
17 allowing for easy starts in the busy winter season. The streamlining and consistent
18 application of policies and procedures has improved overall operations. This
19 consolidation has been a significant cost saving and performance success.
- 20 • Through supply-side conservation, Milwaukee Water Works has saved over one billion
21 gallons of treated water in the two year period from 2006 to 2008. The retail value of
22 this water if billed to a City of Milwaukee customer is \$ 979,000. Modification of filter
23 backwash procedures has an ongoing savings of 165 million gallons per year. The
24 invention of a tank-rinsing device saves about 500,000 gallons per year. Water wasted

1 from illegally opened hydrants has decreased from an estimated 447 million gallons in
2 2006 (745 hydrants) to 63 million gallons in 2009 (105 hydrants) by the judicious
3 installation of locking devices on the hydrants. Distribution system leak surveys and
4 preventive maintenance activities identify water leaks for prompt repair. These
5 activities are summarized in Exhibit 1.4.

- 6 • Milwaukee Water Works is continually looking to reduce electrical energy use
7 throughout its operations. Cost-reducing improvements to lighting, heating-ventilating-
8 air conditioning, windows, and pumping are also described in Exhibit 1.4.

9 In summary, a rate increase was requested because cost increases have outpaced savings
10 that the utility has created through efficiencies in operations and, exacerbated by declining
11 water sales, revenues are inadequate to cover costs.

12 **Q. How did you determine the magnitude of the rate increase to be requested?**

13 A. As the Application to Increase Water Rates was being prepared, it was clear that MWW cash
14 reserves were being depleted to cover the costs of the operating and capital activities of the
15 utility. In addition, the application for the test year of 2010 anticipated cost increases of
16 approximately \$ 5.7 million over 2009. Considerations in selecting the requested rate of return
17 included that the rate of return be no greater than the PSCW benchmark of 7.4 percent*, that
18 the increase would generate sufficient revenue to continue utility operations at existing service
19 levels and also begin to replenish cash reserves, that the rates in effect would maintain MWW's
20 competitive position both locally and nationally, and that the rate increase to customers would
21 not be overly burdensome.

22 **Q. You specified rates of return to the City of Milwaukee and suburban wholesale customers of**
23 **5.0 percent and 6.5 percent, respectively. Why did you request two different rates of return?**

1 A. A higher rate of return was requested for wholesale customers to reflect the higher risk burden
2 of MWW in providing water and to reflect the weight of decisions and foresight required by
3 MWW that are not reflected in the cost of providing the service. The higher risks taken by
4 MWW include the provider's inability to withdraw service from a wholesale customer (the
5 "obligation to serve"), while the wholesale customer has the ability to cancel service (in accord
6 with the terms of the applicable water service agreement). The American Water Works
7 Association gives support to the concept of differential rates of return for in city vs. out of city
8 customers. The Principles of Water Rates, Fees, and Charges Manual M1 (Fifth Edition, page 71)
9 states, "Generally, where inside-city owners provide service to outside city non-owners, a
10 differential rate of return is appropriate." PSCW has already approved the concept of differing
11 rates of return. Such a rate structure is in effect in, for example, Oak Creek.

12 Revenue from wholesale customers made up 14 percent of MWW revenue from the
13 sale of water in 2008 and also in 2009, so a differential rate of return seemed to be an equitable,
14 non-discriminatory way for MWW to be compensated by wholesale customers for the higher
15 risks borne by MWW. Also, since it was projected that a 1.5 percent difference in the ROR
16 would generate a small additional amount in revenue from all the wholesale customers
17 combined, this would not create a situation in which the wholesale customers were subsidizing
18 the retail customers. In fact, the PSCW revenue requirement determined that the "difference
19 between a 5.00 percent and a 6.50 percent ROR for wholesale customers provides for an
20 additional \$ 653,385 in revenue", clearly not a subsidy to the retail customers.

21 **Q. Have Milwaukee Water Works and Clean Wisconsin reached a resolution to the concerns that**
22 **caused Clean Wisconsin to intervene in this rate case?**

23 A. Yes. MWW and Clean Wisconsin are working collaboratively to assist MWW customers to
24 reduce water use and conserve the valuable resource. The outreach effort was launched on

1 March 15, 2010 with a "Fix A Leak Week" booth in Milwaukee City Hall and development of
2 written materials made available to customers in hard copy and on the MWW web site,
3 www.milwaukee.gov/water. A letter was sent to the PSCW on March 16, 2010 summarizing the
4 agreed-upon activities. This letter has been filed as Exhibit 1.5.

5 **Q. Did you obtain authority from your governing body for a rate increase?**

6 A. Yes. Filed as exhibits are certified copies of Milwaukee Common Council Resolutions granting
7 authority to apply for a rate increase (Resolution 090142, Substitute resolution relative to a rate
8 increase for Milwaukee Water Works, effective June 25, 2009, Exhibit 1.6), authorizing the rates
9 of return to be requested (Resolution 090239, Substitute resolution relative to a rate increase
10 strategy for Milwaukee Water Works, effective August 5, 2009, Exhibit 1.7) and affirming the
11 revenue requirement determined by the Public Service Commission of Wisconsin without
12 modification of the rates originally requested (Resolution 090866, Substitute resolution relating
13 to the preliminary findings of the Public Service Commission of Wisconsin relative to a water
14 rate increase, effective January 29, 2010, Exhibit 1.8).

15 **Q. Did you notify your customers of your application for a rate increase?**

16 A. Yes. A notice was published in the Milwaukee Journal Sentinel on September 6, 2009
17 announcing that the request for an increase had been filed with the PSCW. A certified copy of
18 this notice has been filed as Exhibit 1.9.

19 **Q. In what form did you petition the Public Service Commission for a rate increase?**

20 A. On September 1, 2009 an application was submitted in the form prescribed by the Commission.
21 A copy of the application and associated proposed schedules has been filed as Exhibit 1.10.

22 **Q. What action did the PSC take after receiving your application?**

1 A. The PSC staff conducted an audit of the accounting records of the Milwaukee Water Works. In
2 January 2010 a draft revenue requirement was prepared for the test year. On April 1, the Cost of
3 Service Study and Rate Design Proposal were released.

4 **Q. Did you agree with the January 2010 draft of the revenue requirement?**

5 A. Yes. The Revenue Requirement Exhibit dated January 5, 2010 was reviewed and accepted in
6 Milwaukee Common Council Resolution 090866, Substitute resolution relating to the
7 preliminary findings of the Public Service Commission of Wisconsin relative to a water rate
8 increase which was effective January 29, 2010 and is included as Exhibit 1.8.

9 **Q. Did you agree with the Cost of Service Study and Rate Design Proposal?**

10 A. We reviewed the documents that were provided on April 1. We are waiting to review the
11 narrative testimony that is to be provided on or about April 23, 2010 to fully evaluate the cost of
12 service study and rate design. Pursuant to oral and written communications with PSCW staff,
13 MWW will be permitted to fully respond in rebuttal testimony due May 14, 2010.

14 **Q. Why did MWW request an economic development rate for water, and did you agree with the**
15 **Proposed Economic Development Water Rate for Milwaukee Water Works?**

16 A. MWW has significant excess capacity in both water treatment and distribution. While this
17 excess capacity offers redundancy and resiliency that benefit all ratepayers, there are fixed costs
18 associated with it that are borne by ratepayers. City of Milwaukee leaders considered that the
19 addition of new water-intensive industries, or expansion of existing water-intensive industries,
20 could absorb some of the available excess capacity and mitigate costs related to that excess
21 capacity, and also benefit taxpayers by the addition of tax base and new jobs. Exhibit 1.11 is
22 Resolution 091138, Substitute resolution directing the Superintendent of the Milwaukee Water
23 Works to request that the Public Service Commission of Wisconsin establish a reduced water

1 rate for water intensive businesses that relocate to or expand within the city of Milwaukee and
2 meet specific job creation and water use criteria, effective on January 29, 2010.

3 The Proposed Economic Development Water Rate for Milwaukee Water Works that was
4 released by PSCW on April 1 was reviewed. We are waiting for the narrative testimony that is to
5 be provided on or about April 23, 2010 to fully evaluate the economic development rate
6 proposal. Pursuant to oral and written communications with PSCW staff, MWW will be
7 permitted to fully respond in rebuttal testimony due May 14, 2010.

8 **Q. Did you notify your customers of this hearing?**

9 A. Customers have not been notified as of the date this testimony was filed. Confirmation of
10 notification and certified copies of proof of that notice will be provided in upcoming testimony.

11 **Q. Does this conclude your direct testimony?**

12 A. Yes.